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# FVCCF UPDATE 94 - 2

MAY 1994

AN INFORMATION RELEASE FOR **FISHING VESSEL CAPITAL CONSTRUCTION FUND** AGREEMENT HOLDERS

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## Revenue Ruling 94-26

New Revenue Ruling 94-26 - *Tax Incentives Relating to Merchant Marine Capital Construction Funds* affects FVCCF agreementholders who are individuals. This revenue ruling amplifies and explains instructions for filing Individual tax return Form 1040 that have been published in IRS Publication 595, *Tax Guide for Commercial Fishermen*, since 1992.

Rev. Rul. 94-26 clarifies the IRS position that deductions for CCF deposits are a reduction of an individual taxpayer's Taxable Income, not a reduction of gross income, business income, or Adjusted Gross Income (AGI). These directions make it clear that certain limitations based on AGI (for example, percentage limitations for medical and miscellaneous deductions on Schedule A - Itemized Deductions) are computed using the higher number.

IRS Publication 595 and Rev Rul 94-26 explain that the deduction available to a taxpayer for valid deposits to the FVCCF depository should not be reported as a deduction on Schedule C or any other reduction of Adjusted Gross Income (AGI). Instead, the CCF deduction should be entered on page two of Form 1040 as a reduction of line 37, Taxable Income. Write "CCF" and the deduction amount in the margin next to Line 37.

*The revenue ruling is effective for tax years beginning after 12/31/91. We have observed that many returns prepared for the 1992 and 1993 tax years do not conform to these instructions. We suggest you discuss options for amending your 1992 and 1993 tax returns with your professional accountant. If you do amend your tax returns, a copy, as filed with the IRS, must be sent to us at the address above. Please attach a copy of any schedules that changed. Clearly mark them "AMENDED". Also send an amended NOAA Form 34-82. (Please note expanded instructions in this mailing).*

Overdeposits documented by amended returns may be withdrawn from depository accounts. Alternatively, the overdeposit may be carried over and used in the next subsequent year. (Investment earnings on these overdeposits must be reported on the tax return of the year earned, whether or not they are withdrawn.)

## **1993 Form 1040 returns that have not yet been filed should comply with this revenue ruling.**

*See FVCCF UPDATE 94 - 1 to order IRS Publication 595. We strongly suggest that you obtain this publication every year.*

## Self-Employment Tax

IRS Publication 595 explains that net profit or loss from fishing business may not be reduced by deductions for CCF deposits for purposes of computing self-employment tax. A number of fishermen's tax returns have been audited on this issue, and the IRS position has been upheld in court. Legislation will probably be required to change this treatment.

#### Bank and Tax Preparation Fees

Qualified withdrawals are permitted only for purposes of the acquisition, construction, or reconstruction of a qualified vessel. Generally, these expenditures must be of a nature that would ordinarily be capitalized, not expensed. See Merchant Marine Act of 1936 (MMA), Section 607(f) and Joint Regulations, 26 CFR Section 3.0(f).

We have recently noted Deposit/Withdrawal reports showing bank and tax preparation fees as withdrawals. *These fees may not be treated as qualified withdrawals.* NMFS, using its authority to administer the FVCCF agreements will permit agreement holders to correct 1992 and 1993 returns with these withdrawal errors in one of three ways:

- (1) Redeposit the funds withdrawn in error **by October 15, 1994**. Notify us in writing of the redeposited funds, and report this redeposit on 1994 deposit/withdrawal reports.
- (2) Amend tax returns to recognize and pay tax on investment income, if this income was left in the depository account. This is possible only if fees paid were less than investment earnings left on deposit. (This treatment assumes that interest or other earnings on FVCCF deposits were withdrawn to pay these expenses.) Regular income tax must be paid on these "withdrawals." Submit copies of amended tax returns and NOAA Form 34-82 for the years affected. This correction may be made at the same time that amended returns are prepared for 1992 and 1993 to comply with Rev. Rul. 94-26.
- (3) Declare previously deducted fees to be non-qualified withdrawals on 1993 or 1994 tax returns. (Nonqualified withdrawals are taxed at 39.6 percent for individuals plus an interest penalty calculated on a FIFO from the Ordinary Income subceiling.) We are currently updating instruction for handling non-qualified withdrawals. Please request a copy of these instructions, if needed.

If this reporting requirement is not met, NMFS is required to make this adjustment and report the non-qualified withdrawal to the IRS. As a practical matter, this adjustment will only be made for 1992 and later tax years unless the amount so withdrawn in earlier years is material.

#### Requests for Withdrawal Permission Now Required in Writing

**As of May 1, 1994, all withdrawal requests from FVCCF depositories must be in writing.**

Attach a completed Schedule B to the request. If a Schedule B is already on file for this objective (for a purchase, construction, or reconstruction), attached an updated copy with current information about the objective, including vessel description, estimated cost of objective, and projected dates.

Requests for permission to withdraw may be FAXed to NMFS at 301/589-2686.

We should be able to provide FAXed conditional permission for your withdrawal request within two business days **if** all previously required documentation has been submitted to NMFS. (Your file must be up to date before withdrawal permission will be granted. This includes meeting requirements of earlier withdrawal permission letters, certificates of completion of earlier objectives, and deposit/withdrawal reports and tax returns for all years.)

**Caution #1:** *Occasionally, we may ratify an otherwise qualified withdrawal on an after-the-fact basis. However, approval must be requested before the due date of the tax return, including extensions. (See UPDATE 94-1, page 3.)*

**Caution #2:** *NMFS permission to withdraw is always conditional upon complying with terms of the Interim Capital Construction Fund Agreement and timely submission of "such further proofs, assurances, and advices as the Secretary [of Commerce as administered by NMFS], in his discretion, may require" (46 CFR Section 259.37). The NMFS letter of permission for withdrawal specifies items that must be submitted within 60 days of completion of an objective.*